

Message Text

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FM AMEMBASSY PANAMA

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C O N F I D E N T I A L SECTION 1 OF 3 PANAMA 6268

EO 11652: GDS

TAGS: ECON, EFIN, PN

SUBJECT: ECONOMIC ANALYSIS OF PANAMA: PART I: PUBLIC SECTOR
DEBT/DEBT SERVICE - 1975-80

1. THIS IS THE FIRST IN A SERIES OF ECONOMIC STUDIES BEING
PREPARED BY THE MISSION ON THE STATE OF PANAMANIAN ECONOMY
AND PROJECTIONS FOR ITS FUTURE. THE DEBT SERVICING PROBLEM
WILL BE UNDER CONTINUOUS REVIEW. MISSION WELCOMES DEPART-
MENT AND A.I.D. COMMENTS AND QUESTIONS IN ORDER TO INCORPORATE
YOUR CONCERNS FULLY INTO OUR ANALYSIS AND REPORTING PROGRAM.

2. SUMMARY: WE PROJECT ANNUAL SERVICING REQUIREMENTS
OF THE GOVERNMENT OF PANAMA (GOP) TOTAL PUBLIC SECTOR DEBT
(INCLUDING AUTONOMOUS AGENCIES) TO INCREASE FROM \$120
MILLION IN 1975 TO \$250-300 MILLION BY 1980 (5.7 PERCENT TO
7-8 PERCENT OF GDP). MOST OF THIS INVOLVES EXTERNAL DEBT. THE
PROJECTIONS ANTICIPATE LOAN DISBURSEMENTS TO THE TOTAL PUBLIC
SECTOR AVERAGING \$275-350 MILLION ANNUALLY, PRIMARILY FROM
FOREIGN SOURCES. OUTSTANDING DEPT RISES FROM \$1028 MILLION
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1975 TO \$1890-2260 IN 1980--\$616 TO \$975-1165 PER

CAPITA, ONE OF THE HIGHEST IN THE WORLD. PRIVATE EXTERNAL CREDITS, PRIMARILY 5-10 YEAR BANK LOANS WITH ROUGHLY 10 PERCENT RATES, DOMINATE THE GOP TOTAL PUBLIC DEBT PICTURE--ACCOUNTING FOR 44 PERCENT OF TOTAL DEBT SERVICING IN 1975, 59-65 PERCENT IN 1980; AND 42 PERCENT OF TOTAL DEBT OUTSTANDING IN 1975, 35-44 PERCENT IN 1980. DIRECT DEBT SERVICE OBLIGATIONS OF THE CENTRAL GOVERNMENT (EXCLUDING AUTONOMOUS AGENCIES) ARE PROJECTED TO INCREASE FROM \$65 MILLION IN 1975 TO \$170-200 MILLION IN 1980, 22 PERCENT TO 36-43 PERCENT OF CENTRAL GOVERNMENT REVENUES. THIS INCREASE WOULD ABSORB SUCH A LARGE PORTION OF CURRENTLY ANTICIPATED REVENUES THAT ADEQUATE FUNDING OF ESSENTIAL INCREASES IN OTHER CURRENT EXPENDITURES OF THE CENTRAL GOVERNMENT WOULD BE IMPOSSIBLE. THUS, THE GOP MUST SEEK RELIEF THROUGH A COMBINATION OF DEBT RE-SCHEDULING, ADDITIONAL REVENUE, AND SUBSTANTIAL ECONOMIC ASSISTANCE IF ITS DEBT SERVICING OBLIGATIONS ARE TO BE MET WITHOUT CURTAILING ECONOMIC GROWTH AND SOCIAL EQUITY PROGRAMS. ALTHOUGH THE GOP FORESEES AN EASING OF ITS DEBT SERVICE BURDEN AFTER 1980, WE SEE NO PROJECTION OF ANY ROUNDING OFF OR DECREASE DURING THE NEXT FEW YEARS.

3. TOTAL PUBLIC SECTOR DEBT: THE FOLLOWING TABLE SUMMARIZES TWO SETS OF MISSION PROJECTIONS OF ANNUAL LOAN DISBURSEMENTS TO THE GOP, DEBT SERVICING REQUIREMENTS, AND DEBT OUTSTANDING FOR 1975-80. DIFFERENCES BETWEEN THE PROJECTIONS ARE BASED ON DIFFERING ASSUMPTIONS AS TO ANNUAL DISBURSEMENT LEVELS. PROJECTION A REFLECTS APPROXIMATELY \$350 MILLION AVERAGE ANNUAL GROSS NEW BORROWING BY THE GOP TOTAL PUBLIC SECTOR AS CALLED FOR IN THE GOP'S 1976-80 ECONOMIC DEVELOPMENT PLAN. PROJECTION B REFLECTS ANNUAL BORROWING OF \$275 MILLION, I.E., SOME STRETCHOUT IN THE PLAN'S IMPLEMENTATION, WITH \$75 MILLION PER YEAR LESS FROM PRIVATE EXTERNAL FINANCING. DEBTS OF THE CENTRAL GOVERNMENT AND ITS AUTONOMOUS AGENCIES HAVE NOT BEEN SEPARATELY IDENTIFIED FOR THE MOST PART IN THIS ANALYSIS, SINCE THE MAIN FOCUS IS ON TOTAL PUBLIC SECTOR DEBT SERVICING. BASED ON 12 PERCENT AVERAGE ANNUAL GROWTH IN CURRENT PRICE GROSS DOMESTIC PRODUCT (GDP) DURING 1976-80, OR 7 PERCENT IN REAL TERMS ACCORDING TO THE PLAN, TOTAL PUBLIC SECTOR DEBT SERVICE WILL INCREASE FROM 5.7 PERCENT OF GDP IN 1975 (\$2.1 BILLION) TO ABOUT 7 PERCENT (PROJECTION B) OR 8 PERCENT (PROJECTION A) OF 1980 GDP (\$3.7 BILLION).

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PUBLIC SECTOR DEBT - 1975-80

\$ MILLIONS (CURRENT PRICES)

TOTAL PUBLIC SECTOR (ACC) (EST)	PROJECTED					
(CENTRAL GOVT. PLUS						
AUTONOMOUS AGENCIES)	1975	1976	1977	1978	1979	1980

PROJECTION A

DISBURSEMENT	291	332	350	345	350	360
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AMORTIZATION	62	70	75	85	125	150
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INTEREST	58	75	95	115	135	150
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TOTAL	120	145	170	200	260	300
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OUTSTANDING 12/31	1,028	1,290	1,565	1,825	2,050	2,260
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PROJECTION B

DISBURSEMENT	291	242	275	270	275	285
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AMORTIZATION	62	70	75	85	125	130
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INTEREST	58	75	90	100	115	120
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TOTAL	120	145	165	185	240	250
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OUTSTANDING 12:31	1,028	1,200	1,400	1,585	1,735	1,890
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CENTRAL GOVERNMENT
ONLY (EXCLUDING
AUTONOMOUS AGENCIES

CURRENT REVENUE(PLUS

12 PERCENT PER

ANNUM)	290	300	335	375	420	470
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PROJECTION A

DIRECT DEBT SERV(EST) 65	100	115	135	175	200
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BAL AVAIL FOR OTHER

CURRENT EXPENDITURES	225	200	220	240	245	270
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PROJECTION B

DIRECT DEBT SERV(EST) 65	100	110	125	160	170
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BAL AVAIL FOR OTHER

CURRENT EXPENDITURES	225	200	225	250	260	300
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OTHER CURRENT EXPEND

(PLUS 10 PERCENT

PER ANNUM) (EXCLUD-

ING DEBT SERVICE)	240	250	275	300	330	360
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4. DOMESTIC DEBT: ABOUT \$360 MILLION (35PCT) OF \$1028 MILLION TOTAL PUBLIC SECTOR DEBT OUTSTANDING AT THE END OF 1975 WAS CLASSIFIED BY THE GOP AS DOMESTIC DEBT. WE PROJECT AN INCREASE TO \$630 MILLION IN 1980, OR 28 PCT OF TOTAL PUBLIC SECTOR DEBT UNDER PROJECTION A, 35 PCT UNDER PROJECTION B. HOWEVER, ONLY DOMESTIC BONDS OUTSTANDING (\$98 MILLION IN 1975) AND DEBT TO THE SOCIAL SECURITY SYSTEM (\$107 MILLION) ARE CLEARLY OF DEMESTIC ORIGIN (ROUGHLY 20 PCT OF THE TOTAL). THE BULK OF THE REMAINING DOMESTIC DEBT IS OWED TO LOCAL BANKS, ALTHOUGH A SUBSTANTIAL PORTION OF THIS IS ULTIMATELY OWED TO FOREIGN CREDITORS. THUS, A CLEAR DISTINCTION BETWEEN FOREIGN AND DOMESTIC DEBT IS NOT POSSIBLE. PROJECTED DOMESTIC BORROWING OF \$80 MILLION ANNUALLY DURING 1976-80, USING THE GOP CLASSIFICATION, CONSISTS OF \$20 MILLION FROM DOMESTIC BONDS AND THE SOCIAL SECURITY SYSTEM AND \$60 MILLION FROM DEMESTIC BANKS AND SUPPLIERS (AVERAGE TERMS: 5 YEARS, 8 PCT). ON THIS BASIS, DOMESTIC DEBT SERVICING IS PROJECTED TO RISE FROM \$53 MILLION IN 1975 (44 PCT OF THE TOTAL) TO ABOUT \$70 MILLION IN 1980 (26 PCT OF THE TOTAL UNDER PROJECTION A, 23 PCT UNDER CONFIDENTIAL

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PROJECTION B). AS INDICATED ABOVE, THE PROPORTION OF TOTAL GOP PUBLIC SECTOR DEBT AND SERVICING BURDEN THAT IS ACTUALLY OF DOMESTIC ORIGIN IS LESS THAN THESE RATIOS INDICATE.

5. EXTERNAL DEBT-OFFICIAL SOURCES: THE TOTAL PUBLIC SECTOR INCLUDING AUTONOMOUS AGENCIES HAD OUTSTANDING DEBT FROM OFFICIAL SOURCES (PRIMARILY AID, IBRD, IDB, EXIM) OF \$239 MILLION AT YEAR-END 1975, OR 23 PCT OF THE TOTAL. THIS IS PROJECTED TO INCREASE TO \$635 MILLION BY 1980-- 28 PCT OF THE TOTAL UNDER PROJECTION A, 35 PCT UNDER PROJECTION B. BOTH PROJECTIONS A AND B ASSUME DISBURSEMENTS FROM THESE AGENCIES AT AN AVERAGE \$95 MILLION ANNUAL RATE DURING 1976-80, A RELATIVELY OPTIMISTIC PROJECTION OF DRAWDOWNS OF APPROVED BUT NOT FULLY DISBURSED LOANS PLUS OTHER LOANS CURRENTLY UNDER CONSIDERATION. THESE ARE TO FINANCE REVENUE GENERATION/IMPORT SAVING PROJECTS SUCH AS COPPER, HYDRO-ELECTRIC, EXPANDED FREE ZONE, FISHERIES, OIL PIPELINE, AND CONTAINER PORT. HOWEVER, MOST DO NOT COME ON STREAM UNTIL THE EARLY 1980'S AND THEREFORE CAN CONTRIBUTE LITTLE TO DEBT SERVICING DURING 1976-80. FOR THE NON-APPROVED PORTION, AN AVERAGE INTEREST RATE OF 5 PCT AND TERM OF 24 YEARS WITH FOUR YEARS GRACE WAS ASSUMED. BECAUSE OF RELATIVELY SOFT TERMS, THE SERVICING BURDEN FOR THIS CATEGORY OF DEBT WILL CONTINUE TO BE RELATIVELY LIGHT, RISING FROM \$13.6 MILLION IN 1975 (12 PCT OF TOTAL) TO \$35 MILLION IN 1980 (12 PCT OF TOTAL, PROJECTION A; 14 PCT, PROJECTION B).

6. EXTERNAL DEBT FROM PRIVATE SOURCES: THIS CATEGORY DOMINATES THE GOP DEBT PICTURE, TOTALLING \$430 MILLION OR 42 PCT OF GOP PUBLIC SECTOR INDEBTEDNESS AT THE END OF 1975. (OVER 50 PCT IF THE ACTUAL FOREIGN SOURCE PORTION OF DOMESTIC DEBT IS INCLUDED.) IT CONSISTS LARGELY OF BANK CREDITS (90PCT), WITH THE REST IN SUPPLIER CREDITS AND EXTERNAL BONDS. THE BANK CREDIT PORTION IS MOSTLY MEDIUM TERM (5-10 YEARS) AND HAS AN AVERAGE INTEREST RATE OF APPROXIMATELY 10 PCT. AS A CONSEQUENCE, DEBT SERVICE FOR THIS CATEGORY ALSO DOMINATES TOTAL GOP PUBLIC DEBT SERVICING, \$53 MILLION OR 44 PCT OF THE TOTAL IN 1975. ANNUAL SERVICING OF EXISTING DEBT (12/75) PLUS THE 1976 \$80 MILLION CITICORP LOAN RISES FROM \$53 MILLION IN 1975 TO \$115 MILLION IN 1980. ADDITIONAL DISBURSEMENTS OF \$100 MILLION ANNUALLY DURING 1977-80

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(PROJECTION B, I.E., LEAVING ANNUAL PLAN LEVELS SHORT BY \$75 MILLION), WITH 10 PCT INTEREST AND EIGHT-YEAR MATURITIES, INCLUDING THREE-YEAR GRACE PERIODS, INCREASES DEBT SERVICE PAYMENTS BY \$35 MILLION ANNUALLY BY 1980. AT THE \$175 MILLION ANNUAL LEVEL CONSISTENT WITH THE GOP'S FIVE YEAR PLAN

(PROJECTION A), THE INCREASE IN ANNUAL SERVICING REQUIREMENTS FOR PRIVATE EXTERNAL DEBT WOULD REACH \$80 MILLION BY 1980. THUS, GOP RECOURSE TO COSTLY INTERMEDIATE TERM BORROWING FROM PRIVATE SOURCES IN LIEU OF MORE FINANCING FROM DEVELOPMENT FINANCING AGENCIES GREATLY INCREASES THE TOTAL SERVICING BURDEN.

7. A VARIANT NOT SHOWN IN THE ABOVE TABLE, WHICH COULD HAVE A MAJOR IMPACT ON PROJECTED DEBT SERVICING LEVELS, INVOLVES THE ASSUMED THREE-YEAR GRACE PERIOD FOR PRIVATE SOURCE EXTERNAL BORROWING. FOR EXAMPLE, ELIMINATING THE GRACE PERIOD IN PROJECTION B (\$100 MILLION YEARLY PRIVATE EXTERNAL BORROWING) WOULD INCREASE ANNUAL DEBT SERVICING BY AN ADDITIONAL \$50 MILLION BY 1980; IN PROJECTION A (\$175 MILLION RATE), THE ADDITIONAL INCREASE WOULD REACH \$90 MILLION ANNUALLY BY 1980. THUS, THE COMBINED IMPACT OF A DIFFERENCE OF \$75 MILLION ANNUALLY (I.E., \$100 VS \$175 MILLION) IN PRIVATE EXTERNAL BORROWING DURING 1976-80, AND THE DIFFERENCE BETWEEN ZERO AND THREE YEARS GRACE PERIODS FOR SUCH BORROWING--BOTH WELL WITHIN A REASONABLE RANGE OF POSSIBILITIES--COULD RESULT IN A DIFFERENCE IN TOTAL ANNUAL DEBT SERVICING REQUIREMENTS OF AS MUCH AS \$140 MILLION BY 1980 (\$250-390 MILLION). THIS RANGE OF REASONABLY POSSIBLE FUTURE DEBT SERVICE BURDEN COULD BE FURTHER WIDENED BY VARYING THE GRACE PERIOD ASSUMPTION ON PROJECTED BORROWING FROM DOMESTIC BANKS AND SUPPLIERS. (THUS, ANY PROJECTION THAT FAILS TO SPELL OUT ASSUMED TERMS IS RELATIVELY MEANINGLESS.)

8. ALTHOUGH THE RANGE OF REASONABLE DEBT SERVICE PROJECTIONS IS QUITE WIDE, THE LARGE PRESENT SERVICING BURDEN AND ITS EXPECTED RAPID GROWTH EVEN UNDER FAVORABLE ASSUMPTIONS WILL PUT A SEVERE STRAIN ON FUTURE GOP BUDGETS. (THE PROBLEM OF A BALANCE OF PAYMENTS:FOREIGN EXCHANGE GAP NORMALLY ASSOCIATED WITH LDC FINANCING PROBLEMS TECHNICALLY DOES NOT EXIST IN PANAMA'S CASE, SINCE ITS CURRENCY

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IS THE U.S. DOLLAR. HOWEVER, PANAMA OBVIOUSLY FACES THE SAME NEED AS OTHER COUNTRIES TO IMPROVE ITS INTERNATIONAL BALANCE OVER TIME THROUGH INCREASED FOREIGN EARNINGS AND/OR REDUCED FOREIGN EXPENDITURES). OF \$120 MILLION TOTAL DEBT SERVICING IN 1975, APPROXIMATELY \$65 MILLION INVOLVED DIRECT SERVICING BY THE CENTRAL GOVERNMENT (EXCLUDING AUTONOMOUS AGENCIES)--22PCT OF THE CENTRAL GOVERNMENT'S 1975 CURRENT REVENUES. UNDER PROJECTION A THIS RISES TO AN ESTIMATED \$200 MILLION OF THE \$300 MILLION PUBLIC SECTOR TOTAL FOR 1980 (43 PCT OF CURRENT REVENUES) AND UNDER PROJECTION B TO AN ESTIMATED \$170 MILLION OF A \$250 MILLION PUBLIC SECTOR TOTAL (36 PCT OF CURRENT REVENUES). THESE INCREASES IN THE

CENTRAL GOVERNMENT'S DIRECT DEBT SERVICE WOULD ABSORB OVER ONE-HALF IN THE CASE OF PROJECTION A AND ONE-THIRD UNDER PROJECTION B OF 12 PCT ANNUAL GROWTH (7 PCT IN REAL TERMS) OF CENTRAL GOVERNMENT REVENUE.

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9. DEBT SERVICE REQUIREMENTS WITHIN THE RANGES PROJECTED ABOVE WOULD NOT LEAVE SUFFICIENT REVENUES AVAILABLE TO FUND EVEN MINIMUM ESSENTIAL INCREASES IN PRESENT OPERATING EXPENSES OF THE CENTRAL GOVERNMENT, CONSIDERED TO AVERAGE AT LEAST 10 PCT ANNUALLY (5 PCT IN REAL TERMS) (SEE TABLE). ANY UPGRADING OF THE NATIONAL GUARD WOULD ESCALATE ITS ANNUAL COSTS--OPERATING EXPENSES AS WELL AS EQUIPMENT PURCHASES (EVEN ASSUMING FMS CREDIT TERMS)--FAR MORE RAPIDLY THAN THESE POSTULATED RATES. AN INCREASE IN GOP RESPONSIBILITIES FOR ADMINISTERING THE CANAL ZONE, A COMMUNITY OF SOME 40,000 PEOPLE, WOULD BE AN ADDED DRAIN ON THE GOP OPERATING BUDGET. SOCIAL EQUITY PROGRAMS WHICH ARE NOT INCOME PRODUCING, AT LEAST IN THE SHORT RUN, COULD NOT BE FINANCED UNLESS EXTERNAL LENDERS EXTEND EXTREMELY SOFT TERMS. ALSO THERE IS AN IMPLICIT ASSUMPTION THAT THE INCREASING DEBT SERVICING REQUIREMENTS OF THE AUTO-

NOMOUS AGENCIES WILL BE MET FROM THEIR OWN OPERATING REVENUES. THIS IS QUITE UNLIKELY IN SOME CASES BEFORE 1980, WHEN MAJOR REVENUE PRODUCING PROJECTS START COMING ON STREAM, AND IS FAR FROM CERTAIN THEREAFTER. AS GUARANTOR
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OF THE AGENCIES' DEBT SERVICING OBLIGATIONS, THE CENTRAL GOVERNMENT MUST MEET ANY SUCH UNANTICIPTED REQUIREMENTS FROM ITS OWN CURRENT REVENUES.

10. APPREHENSION BY LENDERS OVER THE SEVERE FISCAL PROBLEM FACING THE GOP DURING THE NEXT FIVE YEARS COULD SERIOUSLY UNDERMINE GOP CREDITWORTHINESS AND THUS ACTUALLY INTENSIFY THE PROBLEM. THIS COULD BECOME CRITICAL IN THE CASE OF EXTERNAL PRIVATE LENDERS--MOSTLY BANKS--SINCE THE GOP IS LOOKING TO THIS SOURCE FOR SUBSTANTIAL FINANCING OF ITS INVESTMENT PROGRAM. THE TERMS FOR SUCH BORROWING ARE NOT ONLY FAIRLY HARD ALREADY (5-10 YEARS, 10 PCT OR HIGHER RATES) BUT ALSO ARE SENSITIVE TO PANAMA'S MEDIUM TERM ECONOMIC PROSPECTS AND FISCAL OUTLOOK. THE SUBSTANTIAL IMPACT FROM RELATIVELY MINOR CHANGES IN THESE TERMS WAS DEMONSTRATED ABOVE IN THE CASE OF POSTULATED CHANGES IN THE AVERAGE GRACE PERIOD. THIS SENSITIVITY IS IN MARKED CONTRAST TO MOST LONG-RANGE CONCESSIONAL PROJECT FINANCING FROM INTERNATIONAL DEVELOPMENT FINANCING AGENCIES. WHILE SUCH LENDING IS NOT TOTALLY IMMUNE TO THE GOP'S FINANCIAL OUTLOOK, IT TURNS MORE IMPORTANTLY ON THE MERITS OF THE INDIVIDUAL PROJECTS BEING FINANCED.

11. CONCLUSIONS:

A) PROJECTION OF PANAMA'S TOTAL PUBLIC SECTOR DEBT SERVICING CAN VARY WIDELY, DEPENDING TO A MAJOR DEGREE ON THE ASSUMED VOLUME AND TERMS OF EXTERNAL PRIVATE FINANCING.

B) FAVORABLE ASSUMPTIONS WERE USED IN DEVELOPING BOTH OF THE DEBT SERVICE PROJECTIONS PORTRAYED IN THIS STUDY. HOWEVER, EVEN THESE RELATIVELY OPTIMISTIC PROJECTIONS INDICATE THAT THE CENTRAL GOVERNMENT WILL REQUIRE SUBSTANTIALLY HIGHER REVENUES OVER THE NEXT FIVE YEARS THAN WE CURRENTLY FORESEE, IN ORDER TO COVER ITS DEBT SERVICING OBLIGATIONS AND MINIMUM ESSENTIAL GROWTH OF OTHER CURRENT EXPENDITURES.

C) SINCE MAJOR NEW CAPITAL PROJECTS WILL NOT START PRODUCING ENOUGH INCOME WITHIN THE NEXT FIVE YEARS TO SIGNIFICANTLY AFFECT THE DEBT SERVICING PICTURE, THE GOP MUST FORMULATE AN ECONOMIC STRATEGY WHICH INCORPORATES DEBT RENEGOTIATION, INCREASED REVENUES, AND A SUBSTANTIAL ECONOMIC ASSISTANCE PACKAGE IF ITS
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DEBT SERVICING BURDEN IS TO BE MET WITHOUT CURTAILING ECONOMIC GROWTH AND SOCIAL EQUITY PROGRAMS.

D) THE GOP NOW APPEARS TO BE IN CRITICAL NEED, ON PURELY FINANCIAL GROUNDS, OF EARLY AGREEMENT ON A NEW CANAL TREATY WHICH PROVIDES FOR SUBSTANTIAL ANNUAL COMPENSATION TO PANAMA. THIS WOULD NOT ONLY PROVIDE NEEDED DIRECT RELIEF FOR THE GOP'S ONGOING FINANCIAL PROBLEM; BUT, EVEN MORE IMPORTANT, IS ESSENTIAL TO ASSURE A CONTINUED INFLOW OF PRIVATE FOREIGN CAPITAL ON WHICH PANAMA'S ENTIRE FINANCIAL STRUCTURE DEPENDS.

12. MORE DETAILED TABLES WILL BE SUBMITTED BY AIRGRAM.

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